CONTENTS

		Page
ECONOMIC REPORT OF THE PRESIDENT		1
ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS*		11
CHAPTER 1.	TO RESCUE, REBALANCE, AND REBUILD	25
CHAPTER 2.	RESCUING THE ECONOMY FROM THE GREAT RECESSION	39
CHAPTER 3	CRISIS AND RECOVERY IN THE WORLD ECONOMY	81
CHAPTER 4.	SAVING AND INVESTMENT	113
CHAPTER 5.	ADDRESSING THE LONG-RUN FISCAL CHALLENGE	137
CHAPTER 6.	BUILDING A SAFER FINANCIAL SYSTEM	159
CHAPTER 7.	REFORMING HEALTH CARE	181
CHAPTER 8.	STRENGTHENING THE AMERICAN LABOR FORCE	213
CHAPTER 9.	TRANSFORMING THE ENERGY SECTOR AND ADDRESSING CLIMATE CHANGE	235
CHAPTER 10.	FOSTERING PRODUCTIVITY GROWTH THROUGH INNOVATION AND TRADE	259
REFERENCES		285
APPENDIX A.	REPORT TO THE PRESIDENT ON THE ACTIVITIES OF THE COUNCIL OF ECONOMIC ADVISERS DURING 2009	305
APPENDIX B.	STATISTICAL TABLES RELATING TO INCOME, EMPLOYMENT, AND PRODUCTION	319

*For a detailed table of contents of the Council's Report, see page 15.

CONTENTS

Page

CHAPTER 1. TO RESCUE, REBALANCE, AND REBUILD 25

Rescuing an Economy in Freefall 26

Rescuing the Economy from the Great Recession 28

Crisis and Recovery in the World Economy 29

Rebalancing the Economy on the Path to Full Employment 29

Saving and Investment 29

Addressing the Long-Run Fiscal Challenge 31

Building a Safer Financial System 32

Rebuilding a Stronger Economy 33

Reforming Health Care 33

Strengthening the American Labor Force 35

Transforming the Energy Sector and Addressing Climate Change 36

Fostering Productivity Growth Through Innovation and Trade 37

Conclusion 38

CHAPTER 2. RESCUING THE ECONOMY FROM THE GREAT RECESSION 39

An Economy in Freefall 39

The Run-Up to the Recession 40

The Downturn 41

Wall Street and Main Street 44

The Unprecedented Policy Response 46

Monetary Policy 47

Financial Rescue 49

Fiscal Stimulus 51

Housing Policy 55

The Effects of the Policies 56

The Financial Sector 57
Housing 60
Overall Economic Activity 63
The Labor Market 68
The Challenges Ahead 72
Deteriorating Forecasts 72
The Administration Forecast 75
Responsible Policies to Spur Job Creation 78
Conclusion 79

CHAPTER 3. CRISIS AND RECOVERY IN THE WORLD ECONOMY 81

International Dimensions of the Crisis 82
Spread of the Financial Shock 82
The Collapse of World Trade 87
The Collapse in Financial Flows 89
The Decline in Output Around the Globe 90
Policy Responses Around the Globe 93
Monetary Policy in the Crisis 93
Central Bank Liquidity Swaps 96
Fiscal Policy in the Crisis 98
Trade Policy in the Crisis 100
The Role of International Institutions 100
The G-20 100
The International Monetary Fund 101
The Beginning of Recovery Around the Globe 102
The Impact of Fiscal Policy 104
The World Economy in the Near Term 106
Global Imbalances in the Crisis 108
Conclusion 111

CHAPTER 4. SAVING AND INVESTMENT 113

The Path of Consumption Spending 114
The Determinants of Saving 115
Implications for Recent and Future Saving Behavior 117
The Future of the Housing Market and Construction 120
The Housing Market 121

Commercial Real Estate 123
Business Investment 126
Investment in the Recovery 126
Investment in the Long Run 127
The Current Account 129
Determinants of the Current Account 129
The Current Account in the Recovery and in the Long Run 132
Steps to Encourage Exports 133
Conclusion 135

CHAPTER 5. ADDRESSING THE LONG-RUN FISCAL CHALLENGE 137

The Long-Run Fiscal Challenge 137
Sources of the Long-Run Fiscal Challenge 139
The Role of the Recovery Act and Other Rescue Operations 143
An Anchor for Fiscal Policy 144
The Effects of Budget Deficits 145
Feasible Long-Run Fiscal Policies 146
The Choice of a Fiscal Anchor 148
Reaching the Fiscal Target 149
General Principles 149
Comprehensive Health Care Reform 150
Restoring Balance to the Tax Code 151
Eliminating Wasteful Spending 155
Conclusion: The Distance Still to Go 156

CHAPTER 6. BUILDING A SAFER FINANCIAL SYSTEM 159

What Is Financial Intermediation? 160
The Economics of Financial Intermediation 160
Types of Financial Intermediaries 163
The Regulation of Financial Intermediation in the United States 166
Financial Crises: The Collapse of Financial Intermediation 170
Confidence Contagion 170
Counterparty Contagion 172
Coordination Contagion 173
Preventing Future Crises: Regulatory Reform 174

Promote Robust Supervision and Regulation of Financial Firms 175
Establish Comprehensive Regulation of Financial Markets 176
Provide the Government with the Tools It Needs to Manage Financial Crises 178
Raise International Regulatory Standards and Improve International Cooperation 179
Protect Consumers and Investors from Financial Abuse 179
Conclusion 180

CHAPTER 7. REFORMING HEALTH CARE 181
The Current State of the U.S. Health Care Sector 182
Rising Health Spending in the United States 182
Market Failures in the Current U.S. Health Care System: Theoretical Background 185
System-Wide Evidence of Inefficient Spending 188
Declining Coverage and Strains on Particular Groups and Sectors 191
Health Policies Enacted in 2009 196
Expansion of the CHIP Program 197
Subsidized COBRA Coverage 197
Temporary Federal Medical Assistance Percentage (FMAP) Increase 199
Recovery Act Measures to Improve the Quality and Efficiency of Health Care 201
2009 Health Reform Legislation 202
Insurance Market Reforms: Strengthening and Securing Coverage 202
Expansions in Health Insurance Coverage Through the Exchange 205
Economic and Health Benefits of Expanding Health Insurance Coverage 206
Reducing the Growth Rate of Health Care Costs in the Public and Private Sectors 207
The Economic Benefits of Slowing the Growth Rate of Health Care Costs 210
Conclusion 211

CHAPTER 8. STRENGTHENING THE AMERICAN LABOR FORCE 213

Challenges Facing American Workers 214
Unemployment 214
Sectoral Change 216
Stagnating Incomes for Middle-Class Families 217
Policies to Support Workers 219
Education and Training: The Groundwork for Long-Term Prosperity 221
Benefits of Education 221
Trends in U.S. Educational Attainment 222
U.S. Student Achievement 226
A Path Toward Improved Educational Performance 227
Postsecondary Education 228
Training and Adult Education 229
Elementary and Secondary Education 231
Early Childhood Education 233
Conclusion 234

CHAPTER 9. TRANSFORMING THE ENERGY SECTOR AND ADDRESSING CLIMATE CHANGE 235

Greenhouse Gas Emissions, Climate, and Economic Well-Being 236
Greenhouse Gases 237
Temperature Change 238
Impact on Economic Well-Being 239
Jump-Starting the Transition to Clean Energy 243
Recovery Act Investments in Clean Energy 243
Short-Run Macroeconomic Effects of the Clean Energy Investments 246
Other Domestic Actions to Mitigate Climate Change 247
Market-Based Approaches to Advance the Clean Energy Transformation and Address Climate Change ... 248
Cap-and-Trade Program Basics 248
Ways to Contain Costs in an Effective Cap-and-Trade System 250

Coverage of Gases and Industries 253
The American Clean Energy and Security Act 254
International Action on Climate Change Is Needed 255
Partnerships with Major Developed and Emerging Economies 256
Phasing Out Fossil Fuel Subsidies 257
Conclusion 257

CHAPTER 10. FOSTERING PRODUCTIVITY GROWTH THROUGH INNOVATION AND TRADE 259

The Role of Productivity Growth in Driving Living Standards 261
Recent Trends in Productivity in the United States 262
Sources of Productivity Growth 264
Fostering Productivity Growth Through Innovation ... 266
The Importance of Basic Research 267
Private Research and Experimentation 269
Protection of Intellectual Property Rights 270
Spurring Progress in National Priority Areas 272
Increasing Openness and Transparency 272
Trade as an Engine of Productivity Growth and Higher Living Standards 274
The United States and International Trade 275
Sources of Productivity Growth from International Trade 276
Encouraging Trade and Enforcing Trade Agreements 280
Ensuring the Gains from Productivity Growth Are Widely Shared 282
Conclusion 284

REFERENCES 285

APPENDIXES

A. Report to the President on the Activities of the Council of Economic Advisers During 2009 305
B. Statistical Tables Relating to Income, Employment, and Production 319

LIST OF FIGURES

1-1. House Prices Adjusted for Inflation 27
1-2. Monthly Change in Payroll Employment 28
1-3. Personal Consumption Expenditures as a Share of GDP 30
1-4. Actual and Projected Budget Surpluses in January 2009 under Previous Policy 31
1-5. Real Median Family Income 33
1-6. Total Compensation Including and Excluding Health Insurance 34
1-7. Mean Years of Schooling by Birth Cohort 36
1-8. R&D Spending as a Percent of GDP 37
2-1. House Prices Adjusted for Inflation 40
2-2. Income and Consumption Around the 2008 Tax Rebate 42
2-3. TED Spread and Moody's BAA-AAA Spread Through December 2008 43
2-4. Assets on the Federal Reserve's Balance Sheet 48
2-5. TED Spread and Moody's BAA-AAA Spread Through December 2009 57
2-6. S&P 500 Stock Price Index 58
2-7. Monthly Gross SBA 7(a) and 504 Loan Approvals 60
2-8. 30-Year Fixed Rate Mortgage Rate 61
2-9. FHFA and LoanPerformance National House Price Indexes ... 63
2-10. Real GDP Growth 64
2-11. Real GDP: Actual and Statistical Baseline Projection 65
2-12. Contributions to Real GDP Growth 66
2-13. Average Monthly Change in Employment 68
2-14. Estimated Effect of the Recovery Act on Employment 69
2-15. Contributions to the Change in Employment 71
2-16. Okun's Law, 2000-2009 74
3-1. Interbank Market Rates 83
3-2. Nominal Trade-Weighted Dollar Index 85
3-3. OECD Exports-to-GDP Ratio 87
3-4. Vertical Specialization and the Collapse in Trade 88
3-5. Cross-Border Gross Purchases and Sales of Long-Term Assets 90
3-6. Industrial Production in Advanced Economies 91
3-7. Industrial Production in Emerging Economies 92
3-8. Headline Inflation, 12-Month Change 93
3-9. Policy Rates in Economies with Major Central Banks 94

3-10. Change in Central Bank Assets 95
3-11. Central Bank Liquidity Swaps of the Federal Reserve 97
3-12. Tax Share and Discretionary Stimulus 99
3-13. Outperforming Expectations and Stimulus 105
3-14. OECD Countries: GDP and Unemployment 108
3-15. Current Account Deficits or Surpluses 110
4-1. Personal Consumption Expenditures as a Share of GDP 114
4-2. Personal Saving Rate Versus Wealth Ratio 115
4-3. Personal Saving Rate: Actual Versus Model 118
4-4. Actual Personal Saving Versus Counterfactual Personal Saving 119
4-5. Single-Family Housing Starts 121
4-6. Homeownership Rate 122
4-7. Fixed Investment in Structures by Type 124
4-8. Commercial Real Estate Prices and Loan Delinquencies 125
4-9. Nonstructures Investment as a Share of Nominal GDP 128
4-10. Saving, Investment, and the Current Account as a Percent of GDP 132
4-11. Growth of U.S. Exports and Rest-of-World Income: 1960-2008 134
5-1. Actual and Projected Budget Surpluses in January 2009 under Previous Policy 138
5-2. Actual and Projected Government Debt Held by the Public under Previous Policy 139
5-3. Budgetary Cost of Previous Administration Policy 141
5-4. Causes of Rising Spending on Medicare, Medicaid, and Social Security 142
5-5. Budget Comparison: January 2001 and January 2009 143
5-6. Effect of the Recovery Act on the Deficit 144
5-7. Top Statutory Tax Rates 153
5-8. Evolution of Average Tax Rates 154
6-1. Financial Intermediation: Saving into Investment 161
6-2. Financial Sector Assets 163
6-3. Share of Financial Sector Assets by Type 164
6-4. Confidence Contagion 171
6-5. Counterparty Contagion 173
6-6. Coordination Contagion 174
7-1. National Health Expenditures as a Share of GDP 183
7-2. Total Compensation Including and Excluding Health Insurance 184

7-3. Child and Infant Mortality Across G-7 Countries 190
7-4. Insurance Rates of Non-Elderly Adults 192
7-5. Percent of Americans Uninsured by Age 193
7-6. Share of Non-Elderly Individuals Uninsured by Poverty Status 194
7-7. Medicare Part D Out-of-Pocket Costs by Total Prescription Drug Spending 195
7-8. Share Uninsured among Adults Aged 18 and Over 198
7-9. Monthly Medicaid Enrollment Across the States 200
8-1. Unemployment and Underemployment Rates 214
8-2. Unemployment Rates by Race 215
8-3. Real Median Family Income and Median Individual Earnings 218
8-4. Share of Pre-Tax Income Going to the Top 10 Percent of Families 219
8-5. Total Wage and Salary Income by Educational Group 222
8-6. Mean Years of Schooling by Birth Cohort 224
8-7. Educational Attainment by Birth Cohort, 2007 225
8-8. Long-Term Trend Math Performance 227
9-1. Projected Global Carbon Dioxide Concentrations with No Additional Action 238
9-2. Recovery Act Clean Energy Appropriations by Category 246
9-3. United States, China, and World Carbon Dioxide Emissions 255
10-1. Non-Farm Labor Productivity and Per Capita Income 261
10-2. Labor Productivity Growth since 1947 262
10-3. R&D Spending as a Percent of GDP 270
10-4. Exports as a Share of GDP 275
10-5. Intra-Industry Trade, U.S. Manufacturing 278

LIST OF TABLES

2-1. Cyclically Sensitive Elements of Labor Market Adjustment 70
2-2. Forecast and Actual Macroeconomic Outcomes 73
2-3. Administration Economic Forecast 75
3-1. 2009 Fiscal Stimulus as Share of GDP, G-20 Members 98
3-2. Stimulus and Growth in Advanced G-20 Countries 104
5-1. Government Debt-to-GDP Ratio in Selected OECD Countries (percent) 147

LIST OF BOXES

2-1. Potential Real GDP Growth 76
4-1. Unemployment and the Current Account 130
7-1. The Impact of Health Reform on State and Local Governments 208
8-1. The Recession's Impact on the Education System 224
8-2. Community Colleges: A Crucial Component of Our Higher Education System 230
9-1. Climate Change in the United States and Potential Impacts 240
9-2. Expected Consumption Loss Associated with Temperature Increase 241
9-3. The European Union's Experience with Emissions Trading 252
10-1. Overview of the Administration's Innovation Agenda 266

FEB

2010